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The International Economy and Environment and Development

Report of the Secretary-General of the Conference

I. INTRODUCTION

General Assembly Resolution 44/228 states as one of the objectives of the Conference the following:

"to examine the relationship between environmental degradation and the international economic environment, with a view to ensuring a more integrated approach to problems of environment and development in relevant international forums without introducing new forms of conditionality;"

The Resolution 44/228 also states that "the incorporation of environmental concerns and considerations in development planning and policies should not be used to introduce new forms of conditionality in aid or in development financing and should not serve as a pretext for creating unjustified barriers to trade".

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Decision 1/25 taken by the Preparatory Committee at its first substantive session in Nairobi requested the Secretariat to study amongst other things the following:

- the relationship between the external indebtedness of developing countries and the phenomenon of net transfers of resources from developing to developed countries and their ability to contribute fully and in accordance with their capacities and responsibilities to global efforts to protect and enhance the environment;

- The relationship between the international economic climate, including the need to reverse the terms of trade when these are unfavourable to developing countries, and the degradation of the environment.

The same session, in Decision 1/28, requested the Secretary-General of the Conference "to prepare a paper on the need to harmonize development objectives and sustainability and environmental considerations in deliberations on international economic policy without adding new forms of conditionality or unjustified barriers to trade, as indicated in General Assembly resolution 44/228, section I, paragraphs 15 (h) and (i), bringing out specific issues for consideration by the Preparatory Committee."

The General Assembly in its Resolution 45/210 requested the Secretary-General of the United Nations Conference on Trade and Development (UNCTAD) to prepare an analytical study of the relation between environmental issues and international trade to be submitted to the Preparatory Committee for the United Nations Conference on Environment and Development at its Third Session. The report prepared by UNCTAD in pursuance of this Resolution is placed before the Preparatory Committee as A/CONF.151/PC/48.

II. BACKGROUND

The World Commission on Environment and Development defined sustainable development as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. Implicit in this definition is, as regards particularly developing countries, that extreme poverty must be eliminated and that living standards of many be substantially improved, which involve economic growth. Such economic growth must however take place in a manner that does not cause the degradation of the natural resources base but instead maintain and enhance it. This sustainability constraint on the form of economic growth may lead to an increase in the initial cost of economic growth, which would however be compensated by lower costs later.

An important element of solution of this apparent dilemma between meeting the needs of the present and maintaining the ability to meet the needs of future generations is investment. Investment makes it possible to expand the productive capacity and to generate innovations and changes required to

ensure sustainability. A transition to the use of environmentally sounder technologies is tied closely to the pace and pattern of investment since it is mainly through new equipment, and facilities, etc. that such technologies can be introduced. Increased investment implies increased funding and in the absence of adequate funding the objectives of sustainable development recede into the future.

The mobilization of resources in a way that allows these multiple objectives to be met depends first on domestic policies. This involves a sound domestic macroeconomic management, including prudent fiscal and monetary policies, effective policies of financial sector development, the establishment of a stable and transparent regulatory framework as well as positive measures to encourage entrepreneurship. Equally important is the deployment of a set of market signals and incentives which promote rapid expansion of current output, efficient patterns of investment for the future and the maintenance, rational use and enhancement of the natural resource base that underpins ecological resilience and economic growth. This requires, among other things, careful assessment of the ecological impact of current pricing and of reforms designed to extend the scope of market mechanisms, the incorporation of externalities into pricing structures wherever that is feasible and the development of non-market regulation when it is not. Such economic instruments are the object of the progress Report contained in document A/CONF.151/PC/50.

External factors also affect the manner in which the multiple objectives of expanding current output, investing for the future and maintaining, using rationally and enhancing the natural resources base can be achieved. The external economy impinges on sustainable development through a variety of mechanisms, among which trade relations, financial transactions and transfers of Technology. Transfers of technology are discussed in the report contained in document A/CONF.151/PC/53. The present report will briefly discuss certain issues relating to trade and sustainable development and two mechanisms affecting particularly developing countries: unfavourable changes in terms of trade and the net transfer of resource from developing countries, in their relation with sustainable development. Consideration will also be given to the relationship between structural adjustment programmes and sustainable development.

III. TRADE AND SUSTAINABLE DEVELOPMENT

World trade today is of the order of US$ 6 trillion, the greater part of it being accounted for by the developed economies. However, the conditions governing international trade are of particular importance to the developing countries also since trade plays a crucial role in their drive towards structural transformation and growth.

In the past 40 years world trade has grown at a fast pace. This remarkable expansion in world trade has widened options for consumers and producers in many countries. It has helped to enhance the efficiency of resource use by allowing countries to specialize, to reap the economies of

scale, to upgrade technologies and to focus production in areas where they have a comparative advantage.

From the point of view of sustainability the question is whether the trade regimes and trade patterns that prevail at present help or hinder sustainable resource use. The underlying presumption of trade theory is that, with few exceptions, when trade takes place at prices which reflect real resource cost, scarce resources get efficiently allocated and economic welfare is maximized. In this perspective, trade restrictions in general reduce welfare. These presumptions of trade theory are reflected in the General Obligations of contracting parties to GATT particularly those relating to non-discrimination and the non-use of quantitative restrictions. Negotiations conducted under GATT have also aimed generally at reducing barriers to trade. The major problems of trade have arisen for the most part not from measures which enhance trade between countries but from measures which restricted trade between countries. There are however some exceptions to this particularly those related to the export of domestically banned and hazardous products.

Trade as an Instrument for Widening Options

In developing countries a substantial part of national income and exports depend on the exploitation of natural resources: land, water, forests and mineral resources. The depth and scale of adverse impacts on the ability of developing countries to adopt sustainable development patterns varies from country to country, with the dependence on export income and the nature of products. However, attention should be given to the sectors of agriculture, forestry and fisheries, which constitute the main source of livelihood of many developing countries.

The link between natural resource dependence and income is illustrated by the following table (most data from 1988):

	Low Income Countries	**Middle Income Countries**	**High Income Countries**
GNP per capita, USD	320	1,930	17,080
Agriculture as % of GDP	33	12	4
Employment in agriculture as % of total employment	65	60	13
Exports of primary commodities as % of total exports	48	42	21

Many of the poorest countries depend heavily on natural resources for employment and economic growth, frequently this dependence is extreme: in Tanzania agriculture contributes 66 percent of GDP, Nepal has 93 per cent of its labour force in agriculture, Uganda derives 96 per cent of its export

revenue from coffee, 95 per cent of Zambia's exports is copper ore. Typically the poor countries supply primary commodities for processing in middle or high income countries.

Trade policies that widen the options available for the efficient and sustainable use of these natural resources could result both in the better use of these resources and in higher incomes for producers. The major problems confronting developing countries in this area have more often been problems of market access and tariff structures that discriminate against exports of these resources in more processed forms.

With regard to market access, the principal area of concern has related to agricultural commodities, a matter which is under discussion in the Uruguay Round of Trade Negotiations. Agricultural protectionism in developed countries, whose effects on their own environment are debated, and their subsidized exports of agricultural commodities contribute to lowering prices of agricultural commodities traded by developing countries, thus constraining the ability to exploit these resources in a sustainable manner, and placing these productive sectors under heavy strain.

In the broader field of commodities in general the major difficulty of the developing countries has been the sharp fluctuations in prices leading to great instability in export earnings. This question has been under discussion for a long time and an Integrated Programme for Commodities, with a focus on stabilization of earnings has been discussed within the framework of UNCTAD. But the degree of progress achieved in terms of specific agreements is still very limited. Certain commodity agreements like those for tropical timber and jute include explicit treatment of the concept of sustainability. However, the sustainable exploitation of commodities requires greater stability and predictability of earnings both at the level of the individual producer and the country. These earnings also need to grow without requiring unsustainable resource use for this purpose. However, the dealing in the commodity prices (dealt with later in this paper) and the instability of commodity earnings have eroded the ability of many countries to pursue not just sustainability but any form of development.

In the field of manufactures the major area of concern for developing countries has been market access particularly for items of a labour intensive nature. From the point of view of sustainability market access for manufactures is of relevance as exports of labour intensive manufactures offers a very useful avenue of diversification for many countries which are dependent on the exploitation of the natural resource base. Such diversification would reduce the pressures for excessive exploitation of resources beyond the point of sustainability.

The issues mentioned above are at present under discussion in various international fora including the GATT and UNCTAD. The Preparatory Committee may wish to indicate its views on how trade liberalization and trade expansion can be oriented to widen options for sustainable development and international arrangements for trade in agricultural and other commodities.

Trade restraint on environmental grounds

GATT has been conceived basically as an instrument to liberalize world trade on the general presumption that liberalization is desirable from the point of view of economic welfare. However, the General Agreement includes certain provisions which allow in exceptional circumstances departures from trade liberalization. Article XX of the GATT provides an exception from GATT rules for measures necessary to protect human, animal and plant life or health or for the conservation of natural resources in conjunction with restrictions on domestic production or consumption, provided such measures do not establish a means of unjustifiable or arbitrary discrimination between countries or to disguise restriction on trade. Article XI likewise permits restrictions on imports of agricultural or fisheries products provided production or marketing of the like domestic product is also restricted. A number of measures relating to action taken on these grounds have been addressed under the GATT Dispute Settlement Procedure.

In 1971 the GATT contracting parties set up a group with terms of reference which provide for an examination of specific matters relating to the trade policy aspect of measures to protect the human environment especially with regard to the application of the provisions of the general agreement. However, this group has so far not met.

The interaction between trade and environment does not figure as a separate negotiating issue in the Uruguay Round Negotiations except for certain exemption from obligations arising from the discussion on services and subsidies. An area which does figure in current discussions is the export of domestically prohibited goods. Certain other discussions on sanitary and phyto-sanitary methods have some environmental implications.

A proposal for a study on the relationship between environmental policies and the rules of the multilateral trading system and for the reactivation of the GATT group referred to earlier has been put forward by the EFTA group of countries. This has been discussed most recently in a GATT Council meeting at the end of May 1991.

It is clear that standards for the national environment will be set by the country concerned. Since economic, social and environmental conditions differ greatly between countries, it is very likely that the standards would also differ. Another issue that has arisen in the context of environmental standards is that differences in such standards between countries has an impact on international competitiveness. One question is whether environmental standards should differ between countries. The generally accepted proposition is that they can. If that is the case, then differences in standards per se cannot be a basis for valid trade restraint. In fact, from the point of view of sustainability it would be desirable that differences of environmental conditions are allowed to affect competativity so that international specialization is efficient also from an environmental point of view.

As stated earlier, the right of both developed and developing countries to apply trade measures for the protection of human, animal or plant life or

health and the conservation of exhaustible natural resources is recognized under GATT. The agreement on technical barriers to trade negotiated in the Tokyo Round also allows the environment as a basis for technical regulations but imposes certain obligations like non-discrimination, non-arbitrariness, least trade restrictiveness, etc. The imposition of technical regulations which restrict trade on environmental grounds in a manner that is consistent with these provisions of GATT and the Tokyo Round Agreement of Technical Barriers is not a matter of serious dispute when such technical regulations are directed at protecting the national environment of the country setting them.

One issue that relates to the application of such technical regulations is whether they could apply to products or also to processes. From the point of view of the country receiving the product, a harmful impact on its environment could arise in most cases only from the nature of the product itself rather than how it is manufactured. In certain exceptional cases the country may be affected by the manner in which the product is produced. For example, if a product is produced using CFC's then, in a sense, the importing country shares in the environmental problem caused by the process of production.

Environmental standards are clearly technical in nature. In cases where such standards have to be formulated on an international basis, the appropriate negotiations would generally take place in some technical forum. Such technical agreements often include provisions mandating trade restraint. Some examples of such agreements in recent years include:

- the Montreal Protocol on Ozone Depleting Substances;
- the Basel Convention on the Transboundary Movement of Hazardous Waste;
- Convention on International Trade in Endangered Species;

Environmental principles can be integrated into commodity agreements and this has been done in the International Tropical Timber Agreement as also the International Agreement on Jute and Jute Products. An important issue is the consistency of the trade restraint measures included in such environmental agreements with the General Agreement on Trade and Tariffs. A related issue is the appropriate forum for the resolution of trade related disputes arising from the application of such global agreements.

Some of these global agreements include provision for trade restraint measures against non-parties. This is in part an effort to take care of what is described as the "Free Rider" problem. This is the case where an agreement seeks to tackle a global problem and where a country could refuse to join the agreement and yet benefit from the actions taken by the parties to the agreement. The consistency of such provisions with obligations under GATT is at issue. It is however, generally accepted that trade measures must be proportional to the environmental objectives which are sought to be achieved.

In recent years trade restraint measures or technical regulations imposed on environmental grounds have often been imposed unilaterally rather than on the basis of a prior international agreement on norms or standards. In many cases the restraint relates to the impact of a product on a domestic environment. However, there are certain cases where the restraint has been imposed on grounds which relate not to the national environment but to the transnational environment in the form of the global commons or the national environment of another country. The GATT agreement does not allow explicitly contracting parties to take action to influence conditions within another contracting parties' territory or that parties policies outside the trade field.

The Preparatory Committee may wish to address three broad classes of questions with regard to the issue of trade restraint on environmental grounds:

- the first relates to environmental standards and whether they can differ between countries and what is the extent and nature of harmonization which is required;

- the second relates to the appropriate forum for the setting of such standards and the forum where trade disputes arising from the application of the standards is best resolved;

- the third is whether the standards can relate not just to the national environment of the standard setting country but to transnational considerations relating to the global commons or even to the environmental conditions in the partner country.

IV. DETERIORATION OF TERMS OF TRADE

A deterioration of terms of trade occurs when, over time, the income earned from a certain volume of exports can buy less imports. Commodity prices declined persistently in the 1980's . Between 1980 and 1988, the real prices of non-fuel commodities from developing countries declined by 40 per cent. Fuel prices declined by 50 per cent in the same period. After a short-lived recovery in 1988, the average price index of commodities renewed it decline in 1989.

The impact of these price movements on country groupings and individual countries varied according to the composition of their exports. Commodity-dependent countries lost ground, while countries with more diversified exports and a high share of manufacture exports faced neutral or, in some cases, improving terms of trade. But the fact is that, on the whole, developing countries were adversely affected by changes in terms of trade. Terms-of-trade losses of one country are the gain of another. Industrial countries benefited from the changes in terms of trade in the 1980s.

The magnitude of the impact of unfavourable terms of trade is shown in table 1 and 2 for two groups of countries: at the end of the decade, it is 8 to 9 per cent of GDP for sub-saharan african countries, and between 5 and 6 per cent of GDP in a sample of middle income highly-indebted countries.

Table 1. Sub-Saharan Africa: a/ Combined effects of terms of trade changes and net financial transfers

(Billions of dollars and percentage of GDP)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989 b/
Net financial transfer	1.3	14.5	13.4	8.9	0.8	-1.0	3.9	3.3	5.5	4.0
(GDP 1985: $175 billion) Share in 1985 GDP	0.7	1.8	1.7	1.1	0.1	-0.1	0.5	0.4	0.7	0.5
Terms of trade (1980 = 100) (Value of exports in 1980: $57 billion)	100	95	93	94	100	99	82	74	74	72
Gains (losses) from trade		-2.9	-4.0	-3.4	0.0	-0.6	-10.3	-14.8	-14.8	-16.0
Shares in 1985 GDP		-1.6	-2.3	-2.0	0.0	-0.3	-5.9	-8.5	-8.5	-9.1
Impact on total domestic resource availability		11.7	9.4	5.5	0.8	-1.6	-6.4	-11.5	-9.3	-12.0
Share in 1985 GDP		6.7	5.4	3.1	0.5	-0.9	-3.6	-6.6	-5.3	-6.8

Source: United Nations Department of International Economic and Social Affairs, based on data of the IMF, the World Bank and the United Nations Statistical Office.

a/ Including Nigeria.

b/ Preliminary estimate.

Table 2. Middle-income highly indebted countries: a/ Combined effects of terms of terms of trade changes and net financial transfers.

(Billions of dollars and percentage of GDP)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989 b/
Net financial transfer	8.7	20.5	9.3	-23.8	-40.4	-40.9	-22.8	-28.7	-31.7	-35.0
(GDP 1985: $801 billion)										
Share in 1985 GDP	1.1	2.6	1.2	-3.0	-5.0	-5.1	-2.8	-3.6	-4.0	-4.4
Terms of trade (1980 = 100)	100	97	90	86	90	85	73	73	71	72
(Value of exports in 1980: $161 billion)										
Gains (losses) from trade		-4.8	-16.1	-22.5	-16.1	-24.2	-43.5	-43.5	-46.7	-45.1
Share in 1985 GDP		-0.6	-2.0	-2.8	-2.0	-3.0	-5.4	-5.4	-5.8	-5.6
Impact on total domestic resource availability		15.7	-6.8	-46.3	-56.5	-65.1	-66.3	-72.2	-78.4	-80.1
Share in 1985 CDP		2.0	-0.8	-5.8	-7.1	-8.1	-8.3	-9.0	-9.8	-10.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of the IMF, the World Bank and the United Nations Statistical Office.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia.

b/ Preliminary estimate.

Table 3. Net transfer of financial resources of the capital-importing developing countries, 1980-1989 a/

(Billions of dollars: sample of 96 countries)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989 b/
Transfer through direct investment										
Net investment flow	5.5	9.0	6.4	5.5	5.6	6.3	5.6	8.7	14.1	13
Net dividends and other income	-10.5	-9.9	-9.4	-8.8	-8.0	-7.5	-6.4	-7.0	-7.8	-9
Net transfer	-5.0	-0.9	-3.0	-3.3	-2.5	-1.2	-0.8	1.7	6.3	4
Transfer through private credit										
Medium-term and long-term foreign borrowing										
Net credit flow	35.4	48.3	40.6	26.5	17.8	11.6	7.7	1.4	6.5	6
Interest paid	-24.2	-31.2	-37.2	-35.2	-39.9	-38.9	-34.6	-33.9	-39.2	-42
Net transfer	11.2	17.0	3.4	-8.7	-22.0	-27.3	-27.0	-32.5	-32.8	-36
Short-term borrowing and domestic outflows c/										
Net transfer	0.9	-17.3	-27.2	-18.9	-12.7	-8.6	1.8	3.2	-10.1	7
Transfer through private grants (net)	1.2	1.2	1.2	1.9	2.1	2.5	3.4	3.5	4.2	4
Transfer through official flows										
Official transfers (grants)	11.1	11.7	9.2	10.2	10.7	11.5	11.1	12.3	12.4	12
Net official credits	23.2	28.8	31.6	27.7	25.0	16.5	16.0	12.0	16.0	22
Interest paid	-5.8	-6.8	-8.3	-9.7	-11.3	-12.8	-15.6	-16.9	-18.2	-22
Net transfer	28.6	33.7	32.5	28.2	24.5	15.1	11.5	7.5	10.2	13
Total transfer (financial basis)	36.8	33.8	7.0	-1.2	-10.6	-19.4	-11.1	-16.6	-22.1	-7
Use of official reserves d/	-12.8	2.7	15.9	-8.0	-19.4	1.6	8.7	-14.4	-9.9	-17
Total transfer (expenditure basis)	24.0	36.5	22.9	-9.2	-30.0	-17.8	-2.4	-31.0	-32.0	-24

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of the International Monetary Fund (IMF), OECD, the World Bank and United Nations Secretariat estimates.

a/ Definitions: direct investment is net of reinvested earnings (cash flow approach); official credits include use of IMF credit, and interest includes Fund charges; private grants include net flow of gifts from overseas residents (excluding workers' remittances) and grants by non-governmental organizations.

b/ Preliminary estimate; rounded to the nearest half-billion dollars.

c/ Calculated as a residual (including short-term trade financing, normal and unusual outflows ("capital flight"), arrears on interest due, and other flows captured in balance-of-payments data as "errors and omissions" and presumed to be financial flows).

d/ Additions to reserves shown as negative numbers.

V. NET FINANCIAL TRANSFER OF RESOURCES FROM DEVELOPING COUNTRIES

This issue is discussed in detail in the report of the Secretary-General submitted to the General Assembly at its forty-fifth session, contained in document A/45/487 as well as in The World Economic Survey 1990 (Document E/1990/55). The main elements are that since 1983, traditionally capital-importing developing countries, all developing countries except eight major oil-exporting countries, have, in aggregate, experienced an outward net financial transfer. The conjunction of factors that led to this outflow can be summarized as follows:

(a) Foreign debt in many developing countries had reached high levels. In the second half of the 1970s, developing countries - in particular the newly industrializing among them - had borrowed easily from commercial banks. In those years, since real interest rates were very low, many countries had opted for "growth-cum-debt" instead of earlier retrenchment and adjustment to a lower level of foreign exchange availability;

(b) Interest rates did rise steeply, over a debt structure in which commercial loans at floating rates represented most of the debt. Starting in 1979, the industrialized countries, led by the United States of America, tightened their monetary policies to fight inflation. This brought unprecedented interest levels, which multiplied suddenly the cost of Third World debt;

(c) Because of deteriorating terms of trade and a lack of ability to increase exports earning with sufficient speed, too many countries could not cope with the rapid rise in debt service. The same policies in OECD countries that brought higher interest rates resulted in the world-wide recession of the early 1980s, which depressed export prices from developing countries and reduced markets for their products;

(d) Finance from private creditors dried up suddenly and could not be compensated for by official credit.

The size of the phenomenon is shown in table 3. At the beginning of the 1980's, capital-importing developing countries were receiving net financial transfers in the order of $30 billion year. In recent years, the same countries have been making net outward transfers of a comparable magnitude.

The combined effects of terms of trade and net financial transfer on total domestic resource availability are shown in the lower rows of tables 1 and 2: in Sub-Saharan Africa, losses from terms of trade more than exceed the positive financial transfers, to account for a loss of over 10 billion dollars of total domestic resource availability at the end of the 1980s, or close to 7 per cent of GDP. For the highly indebted middle-income developing countries sampled in table 2, the combined effects of a high negative transfer and terms of trade losses amount to an impact on total domestic resource availability, amounting to US$80 billion or some 10 per cent of GDP.

The realization of the serious consequences of adverse economic factors such as deteriorating terms of trade and negative financial transfers on development and the environment should provide an increased incentive for effectively seeking to correct them. From the view point of sustainable development the measures required for dealing with this are not any different from measures which have been advocated in an essentially economic context. Recommendations made in this regard on previous occasion may therefore be given new consideration.

- Annex 1 reproduces the policy implication contained in the report of the Secretary-General on the net transfer of resources from developing countries.

- Annex 2 reproduces the conclusions contained in the report prepared by the Personal Representative on Debt appointed by the Secretary-General.

Both reports were submitted to the General Assembly at its forty-fifth session.

VI. ADJUSTMENT AND ITS IMPACT ON SUSTAINABLE DEVELOPMENT

Negative net financial transfers are indicative of the amounts that need to be mobilized by an economy and transferred abroad rather than utilized domestically. Deteriorating terms of trade impair the ability of countries that experience them to mobilize the needed resources through exports, or require a greater volume of exports for the same income. In magnitudes as large as those mentioned above, these losses represent a major haemorrhage defeating efforts of developing countries to mobilize and accumulate resources for investment. Figures 1 and 2 illustrate the fall in investment observed in Sub-saharan Africa and in a sample of highly indebted developing countries during the 1980s.

Adjustment programmes recommended by international financial institutions typically consist of short term programmes, which often include reductions in public-sector spending, attempt to increase tax revenues and exchange rate devaluations. In addition, medium to long-term measures are recommended, which often include foreign trade liberalization, removal of price controls and subsidies, financial sector reforms, land reforms etc... Such measures do not all affect sustainable development in the same manner. Some may have positive consequences. Many others have adverse impacts.

In general, the response to situations of financial stringency is likely to involve predominantly policies aiming at generating cash flow immediately and at meeting pressing current needs even if it compromises the future. Such orientation is clearly incompatible with the concern, fundamental to sustainable development of preserving the ability to produce in the future.

The impact of such financial stringency situations on sustainable development takes place mainly through the following processes:

a) Pressure to rapidly increase export volume and income. This may lead to unsustainable exploitation of otherwise renewable natural resources, cultivation of export crops on marginal lands and accelerated depletion of non-renewable resources.

b) Cuts in investments in such areas as infrastructures, equipments, maintenance, lead to a deterioration of productivity, which translates into higher natural resource use for given results. Cuts in investments for natural resource conservation have an obvious negative impact.

c) Deteriorating employment situation due to cuts in investment and cuts in resources allocated to social services are likely to lead to an increase in poverty. Increased poverty translates into environmental degradation through processes reviewed in the report as poverty and environmental degradation: contained in document A/CONF.151/PC/47.

The possibility of adverse environmental consequences should not lead to renouncing correction of major imbalances in the economy. However, measures decided in this regard should be assessed on the basis of their impact on sustainable development, so that current economic stabilization is not achieved at the cost of future ability to produce. The Preparatory Committee may wish to consider how these adverse impacts could be mitigated.

ANNEX 1

Policy Implications Contained In the Report of the Secretary-General On the Net Transfer of Resources from Developing Countries (A/45/487)

The prolonged and large outward transfers of resources and its association to low or negative growth has been a feature of the 1980s. Investment has particularly suffered in indebted countries. The debt crisis and the pattern of financial flows it engendered continue to be the major obstacle to recovery and development in most indebted countries, particularly in Latin America and in Africa. It has also had adverse repercussions on the exports of many industrial countries. 23/ The internal resource mobilization that the outward transfer implies and the actual policy response to the need of such mobilization was a main factor in the budget crisis of several developing countries. Throughout the 1980s the severity of the adjustment to the shift in financial flows has been compounded by adverse changes in terms of trade. In assessing these trends, the international community has recognized that, during the 1980s, the large net transfer of resources to the developed countries has deprived developing countries of much needed resources for development. 24/

The prospects for the 1990s under unchanged policies are bleak for developing economies. Projections of international organizations indicate very little per capita growth in Latin America and the Caribbean and virtual stagnation in Africa. While the international economic environment should be less adverse than that of the 1980s, or might even be favourable, a large number of developing countries are beginning the new decade in a much weaker economic position. A global recession as in the early 1980s, or the prolonged and substantial fall of commodity prices of the last decade, will not necessarily occur in the 1990s. Yet, the starting point for most debtor developing countries is one of depressed investment, deteriorated physical infrastructure and serious balance-of-payments difficulties. Such conditions were not pervasive at the beginning of the 1980s. Massive national and international efforts are required to change these conditions and to revitalize growth and development.

Given the diversity of factors determining the sharp fall in net financial transfers to many developing countries, and given the differences in the ability of countries to cope with these changes, a mix of policy measures in various areas is required. For many countries, the mix will have to include further fiscal adjustment and measures towards export diversification, combined with efforts to create a climate of confidence to increase domestic savings and productive investment, including foreign direct investment and return of flight capital. This is a tall order. For the domestic adjustment to be orderly and at all feasible not only from an economic, but from a socio-political standpoint, the shift in the resource transfer should not be abrupt. This implies restoring a higher degree of stability to the flows of international finance and reducing world interest rates.

There are, so to speak, two sides of the coin in this issue of the abrupt changes in net transfers: one is the financial implications: the other is the ability to cope with such changes via increased export earnings. Stability in commodity prices and elimination of protectionism against products from developing countries would reduce these countries' need for compensatory finance. Improved access to the markets of industrial countries in areas of interest to developing countries such as textiles and clothing, tropical products and agriculture as well as the elimination of tariff escalation in developed countries - which is an obstacle to the export diversification of developing countries - are some of the trade measures called for. Anti-dumping measures should not be used as just one more protectionist tool. Beyond a successful completion of the Uruguay Round of multilateral trade negotiations, structural adjustment will be necessary in industrial countries to enable them to reduce protectionism and make room for competitive manufactures from developing countries. And, not least, policy co-ordination at the international level in order to achieve, in the 1990s, vigorous non-inflationary growth. Such policy co-ordination will have to walk the tightrope between supporting economic growth and avoiding that the new demands on world savings drive up world interest rates.

Notwithstanding the essential character of other interrelated measures, the main contribution to a reduction of the excessive outward transfer of resources from developing to developed countries would come from a concerted public solution to the debt problem. The Brady plan, initially proposed by the former United States Secretary of the Treasury, Nicholas Brady, has the ingredients of a public solution to the debt problem. It recognized that voluntary lending would not start any time soon and that the debt could not be repaid in the original conditions. In an important departure from the previous strategy, the Brady initiative endorsed the commitment of public finance to support debt reduction. The Brady plan created high expectations on the possibility of debt reduction regarding commercial debt, and thus debt-service reduction and diminution of the net negative transfer. It has made some progress in that direction. After very complex and prolonged negotiations, debt and debt-service reduction was obtained in Costa Rica, Mexico, the Philippines and Venezuela. Nevertheless, only a very partial reduction of the debt overhang was achieved.

The unabated increase in the number of reschedulings and in arrears indicates the persistence of the problem. Limited debt reduction, with only a small impact on the debt overhang and on the net negative financial transfer, cannot bring about what is aimed at in the first place, namely, to allow an increase in investments and imports, and in growth. The Brady plan has to be extended rapidly to a larger number of developing countries. Adequate debt reduction is necessary to restore development. There are some 40-odd countries waiting to be eligible for the Brady plan, and various studies have concluded that, on the aggregate, a minimum between one third and 45 per cent is necessary to have an impact on investment and growth. On that account, the Brady plan suffers from under-funding, as evidenced also by the shortage of official collateral funds in the last debt reduction agreements.

Also, the present accounting, tax and regulatory environment in which banks operate calls for examination. Lack of clarity and differences in

national bank law make the negotiations extremely complex and make it difficult to devise a reduction scheme in which all concerned bear their fair share of the cost of debt reduction. To close the unfinished business of the era of concerted lending and move to the concerted acceptance of loss, the case-by-case approach to debt reduction has to be complemented by concerted rules of cost sharing. While at the domestic level countries need to arrive at social consensus on how the burdens and fruits of unavoidable adjustment are to be shared, the international community, to speed up the restoration of adequate flows of finance for development, also badly needs some common rules and agreements on cost-sharing amongst the numerous partners involved.

The Brady plan addressed commercial debt only. It is now recognized that official debt, including to the international financial institutions, will have to be part of a solution. Debt relief for most least developed and other low-income developing countries, particularly in Africa, remains critical. Debt forgiveness form bilateral creditors is particularly important for those among such countries that face serious debt-servicing difficulties.

Following the Toronto Summit decisions, several low-income countries have benefited in the last two years from easier terms and partial write-offs in the reschedulings of official bilateral debt within the framework of the Paris Club. Regarding low-income countries, an increasing number of donor countries have converted official development assistance (ODA) loans into grants, in line with the United Nations Conference on Trade and Development's Trade and Development Board resolution 165 (S-IX). The Enterprise for the Americas Initiative announced on 27 June this year by President Bush, when proposing to reduce the region's official debt to the United States, implicitly recognized the need to extend beyond the poorest countries the Paris Club eligibility criteria for easing the terms of rescheduling and for reducing official bilateral debt. Still regarding official flows, a positive development is the willingness of IMF and the World Bank to make disbursements while a country has not yet finished negotiations with the banks and even if a country has arrears to the banks.

Net official development finance - grants plus net official credits - was virtually at the same level in 1989 as in 1980. The recovery of investment in Africa and Latin America and the consolidation of the vigorous capital accumulation in Asia of recent years will require a substantial increase in net official flows to support internal savings mobilization efforts. In the case of least developed countries and other low-income countries, mostly in Africa, ODA is particularly important to narrow the gap in foreign exchange and savings required to resume growth and increase investments. In other developing countries, official flows remain critical during this period of foreign exchange stringency. The imported component of investments in machinery and equipment tends to be quite high in middle-income developing countries and such investments are a sine qua non for the transformation of productive structures and to increase export potential. It is only after growth has been restored and exports have achieved a certain momentum that private capital - foreign direct investment and commercial bank flows - are likely to again play a significant role in the development process.

ANNEX 2

CONCLUSIONS CONTAINED IN THE REPORT OF THE PERSONAL REPRESENTATIVE ON DEBT OF THE SECRETARY - GENERAL (A/45/380)

(a) The problem of extricating countries and regions with heavy debt burdens from the debt crisis is of a systemic nature and requires the participation of all creditors, not only banks but also Governments and multilateral institutions;

(b) The Brady Plan 2/ should be strengthened and provided with more resources and co-ordinated management from an agency within the international financial institutions, working closely with the regional banks;

(c) Following the decisions of the group of seven major industrialized countries at their Toronto and Paris summits it should be possible to obtain further debt relief as needed, differentiated according to level of development and indebtedness of the various types of debtors. Such alleviation should be achieved through long-term debt rescheduling (40 or 30 years) and greater concessionality on debt service in a measure reflecting the various categories of debtors;

(d) Debt-service should be fully written off only in the case of the poorest countries (the IDA-only group), and only for soft loans under official bilateral assistance programmes;

(e) It should be made possible for countries to pay interest on bilateral debts into trust funds in indexed local currencies, to be used for the financing of development projects for environmental protection and human resources development;

(f) An "intermediate" group of debtor countries, between the poorest and the middle-income countries, should be defined with the view to increasing the degree of concessionality of their debt, applying, as a first measure, the Toronto terms to their rescheduling at reduced interest rates;

(g) There should be a commitment to guarantee an adequate flow of public and private funds to developing countries. The report restates the goal of providing 0.7 per cent of gross domestic product (GDP) as official development assistance: that target was reconfirmed by the Ministerial Council of the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD) at its ministerial meeting on 14 May 1990;

(h) The case-by-case approach should be maintained. However, a clear distinction should be made between different categories of debt, such as debt arising from concessional aid loans, publicly guaranteed debt, non-guaranteed private debts, and debts to international financial institutions. In this context, the status of those institutions as privileged creditors is important both as a support to their concessional lending and as a framework for overall financial stability;

(i) Developing debtor countries and Eastern European countries should adopt cohesive policies of domestic adjustment in collaboration with the international financial institutions. However, adjustment programmes must be selective and growth-oriented. In addition, they should take into account the needs of the less favoured groups of the population;

(j) Private banks should be encouraged, by means of appropriate incentives and co-ordination, to reduce the interest on private debts. Tax and accounting regulations should be revised to favour those creditor banks which reduce interest and provide new financial flows to developing countries;

(k) Consideration should also be given to an increase of the resources of the international financial institutions to be used to finance operations under the Brady Plan and to an SDR (special drawing right) allocation to be used to enlarge the funds available for debt reduction, interest subsidy and bridging loans;

(l) In those indebted countries endowed with a wide range of industrial assets or natural resources, incentives should be provided for "swap" operations that would set up joint ventures and promote the participation of external capital in privatized public enterprises. Commodity bonds should be given public guarantees. Innovative approaches should be considered, such as the payment of part of debt service in bonds expressed in local currency and indexed on export commodities, with the option of using them to purchase shares and other marketable securities;

(m) A special effort must be made to provide financial backing to the countries of Eastern Europe during their transition to a market economy in order to avert serious social shocks. In debt relief, consideration should be given to innovative financing options and the conversion of debt into shares of privatized companies.

It may be estimated that the additional burden on the government budgets of creditor countries of the concessions on bilateral debt would not exceed 0.1 per cent of GDP. This would mean an increase in their aid budgets from 0.35 to 0.45 per cent of GDP.

Special attention should be given to the extension of the system of regional banks. After the recent establishment of the European Bank for Reconstruction and Development, consideration should be given to the establishment of a bank for the Mediterranean region to provide financial flows for enhancing the resources of relevant countries and also to meet the acute problems of population growth and migration.